

**U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE**

HEARING CHARTER

***Tools for Enhancing Small Business Competitiveness in the Dallas Area:
A Review of Federal Programs***

**Friday, January 23, 2004
10 a.m. – 12 Noon (CST)
Bill J. Priest Institute Conference Center
Dallas County Community College
Dallas, Texas**

1. Purpose:

To increase awareness of the Small Business Innovation Research (SBIR) Program and the Small Business Technology Transfer (STTR) Program, and to learn more about the opportunities that these programs offer to small businesses, especially those owned by minorities and women, in the Dallas area.

2. Witnesses:

Mr. Joseph Montes is Administrator of Region VI for the Small Business Administration (SBA) in Dallas, Texas. Mr. Montes will be accompanied by **Mr. Lavan Alexander**, District Director in the Dallas-Fort Worth area for the Small Business Administration.

Ms. Jo Anne Goodnight is Director of SBIR and STTR for the National Institutes of Health (NIH) in Bethesda, Maryland.

Dr. Da Hsuan Feng is Vice President for Research and Graduate Education and Professor of Physics at the University of Texas at Dallas.

Dr. Robert Slocum is Chairman and Chief Technical Officer for Polatomic, Inc, an energy company based in Richardson, Texas.

Dr. Oliver Murphy is President of Lynntech, Inc. of College Station, Texas.

3. Overarching Questions:

The hearing will address the following overarching questions:

- In what ways are the SBIR and STTR programs designed to be of assistance to small businesses that wish to do research and develop innovative products either for the government or the private sector?
- What is the University of Texas at Dallas doing to assist high technology small businesses and how does this relate to the work of the Small Business Administration?
- What is the track record of the SBIR and STTR programs in the Dallas area, including with minority and women-owned businesses, and what is being done to enhance the program's relationship in the area and with underserved populations?

4. Appendix:

Small Business Innovation Research Program, Congressional Research Service Report, December 5, 2003

Summary

In 1982, the Small Business Innovation Development Act (P.L. 97-219) established SBIR programs within the major federal research and development (R&D) agencies. The intent of the effort was to increase government funding of small, high technology companies for the performance of R&D with commercial potential. Federal departments with an R&D budget of \$100 million or more are required to set aside part of this amount to finance the SBIR activity. From its inception in FY1983 through FY2002, over \$13.5 billion in awards have been made for more than 70,000 projects. The original program was extended several times and is currently scheduled to sunset on September 30, 2008.

Program Description

The Small Business Innovation Research program is designed to increase the participation of small, high technology firms in the federal R&D endeavor. Congressional support for the initiative was predicated upon the belief that while technology-based companies under 500 employees tended to be highly innovative, and innovation is essential to the economic well-being of the United States, these businesses were under represented in federal R&D activities. Agency SBIR programs guarantee this sector a portion of the government's research and development budget to compensate for what was viewed as a preference for financing large corporations.

Current law requires that every federal department with an R&D budget of \$100 million or more establish and operate an SBIR program. A set percentage of that agency's extramural research and development budget — originally at 1.25%, now at 2.5% — is to be used to support mission-related work in small companies. (It should be noted that P.L. 97-219 excluded appropriated funds for defense programs in the Department of

Energy from that agency's extramural R&D calculations.) In addition, all departments with R&D spending above \$20 million are directed to establish goals for financing small business R&D at levels higher than the previous year.

The objectives of the SBIR program include stimulation of technological innovation in the small business sector, increased use of this community to meet the R&D needs of the government, additional involvement of minority and disadvantaged individuals in the process, and expanded commercialization of the results of federally funded R&D. To achieve this, agency SBIR efforts involve a three-phase activity. In the first phase, awards up to \$100,000 (for 6 months) are provided to evaluate a concept's scientific or technical merit and feasibility. The project must be of interest to and coincide with the mission of the supporting organization. Projects that demonstrate potential after the initial endeavor can compete for Phase II awards of up to \$750,000 (lasting one-two years) to perform the principal R&D. Phase III funding, directed at the commercialization of the product or process, is expected to be generated in the private sector. Federal dollars may be used if the government perceives that the final technology or technique will meet public needs. P.L. 102-564, a subsequent 1992 reauthorization of the program, directed agencies to weigh commercial potential as an additional factor in evaluating SBIR proposals. This is to encourage funding of projects that may have market applicability rather than those that meet only the needs of government.

Ten departments have SBIR programs including the Departments of Agriculture, Commerce, Defense (DOD), Education, Energy, Transportation, and Health and Human Services; the Environmental Protection Agency; the National Aeronautics and Space Administration (NASA); and the National Science Foundation (NSF). The Departments of Homeland Security and Housing and Urban Development are expected to begin participating in FY2004. Each agency's SBIR activity reflects that organization's management style. Individual departments select R&D interests, administer program operations, and control financial support. Funding can be disbursed in the form of contracts, grants, or cooperative agreements. Separate agency solicitations are issued at established times.

The Small Business Administration (SBA) established broad policy and guidelines under which individual departments operate SBIR programs. The agency monitors and reports to Congress on the conduct of the separate departmental activities. Criteria for eligibility in the SBIR program include companies that are independently owned and operated; not dominant in the field of research proposed; for profit; the employer of 500 or less people; the primary employer of the principal investigator; and at least 51% owned by U.S. citizens or lawfully admitted permanent resident aliens. The SBA operates a computer system to link SBIR awardees with venture capital firms. P.L. 106-554 mandated the establishment of two data bases, one for government and one for the public, that provide information on SBIR programs across departments.

A pilot effort designed to encourage commercialization of university and federal laboratory R&D by small companies was created by P.L. 102-564, reauthorized through FY2001 by P.L. 105-135, and extended through FY2009 by P.L. 107-50. The STTR

program provides funding for research proposals that are developed and executed cooperatively between a small firm and a scientist in a research organization and fall under the mission requirements of the federal funding agency. Up to \$100,000 in Phase I financing is available for one year; Phase II awards of \$500,000 may be made for two years. Financial support for this effort comes from a 0.15% set-aside of the R&D budgets of departments that spend over \$1 billion per year on research and development. According to the provisions of P.L. 107-50, in FY2004 the set-aside will increase to 0.3% and the amount of individual Phase II awards will increase to \$750,000. The Departments of Energy, Defense, and Health and Human Services, NASA, and NSF participate in the STTR program.

Implementation

The General Accounting Office (GAO) is legislatively directed to assess the implementation of the Small Business Innovation Development Act, as amended, and has issued a series of reports documenting its findings. A 1987 study found that both the evaluation and selection processes were sufficient to “reasonably” insure awards were based on technical merit. It was also determined that the majority of agencies were not awarding Phase I grants and contracts within the 6-month time frame required by the SBA guidelines. Another GAO report the following month surveyed the participants and noted that most were “generally satisfied” with the administration of SBIR programs.

In 1989, GAO reported that agency heads found the SBIR effort to be beneficial and met the organization’s R&D needs. Most indicated that the “... SBIR programs had developed new research areas, placed more emphasis on the application of research results, and led to wider use of small businesses as research performers.” The study concluded that projects were, for the most part, of high quality. At DOD and NASA, however, SBIR efforts stressed R&D to meet agency mission requirements in contrast to other SBIR programs that focused on commercialization for private sector markets. All of the departments stated that SBIR projects, when compared with other research activities, had greater potential to result in new products and processes.

Testimony presented by GAO in 1991 stated that the program “... clearly is doing what Congress asked it to do in achieving commercial sales and developmental funding from the private sector.” An SBA study found that approximately one in four SBIR projects will result in the sale of new commercial products or processes. Another GAO report issued in May 1992 noted that despite a short time frame and the fact that many SBIR projects had not had sufficient time to mature into marketable technologies and techniques, “... the program is showing success in Phase III activity.” As of July 1991, almost two-thirds of the projects already had sales or received additional funding (primarily from the private sector) totaling approximately \$1.1 billion.

The 1992 study also identified several issues for possible further congressional exploration. According to GAO, DOD placed less emphasis on commercialization than other agencies and utilized the SBIR program primarily to address the department’s R&D needs. Questions were raised about the requirements for competitive bidding when

companies looked to federal departments for Phase III contracts after successfully completing Phases I and II. GAO noted that clarification of the Competition in Contracting Act of 1984 (as amended) might be necessary. In addition, there was disagreement over whether the federal agency or the small firm should continue to work on technology development after the cessation of SBIR project funding. GAO also concluded that firms receiving multiple Phase II awards tended to have lower Phase III sales and less additional developmental support. The reasons for this remained unclear, but the suggestion was made that these companies may have focused on securing funds through SBIR awards rather than through commercialization of their R&D results.

A March 1995 GAO report found that multiple Phase II funding had become a problem, particularly at NSF, NASA, and DOD. Among the reasons cited were the failure of companies to identify identical proposals made elsewhere in violation of the mandatory certification procedure; uncertainty in definitions and guidelines concerning "similar" research; and lack of interagency mechanisms to exchange information on projects. Several recommendations were made to address duplication. GAO testimony presented in March 1996 indicated that the SBA had taken steps to implement these suggestions. The study also determined that the quality of research appeared to have "kept pace" with the program's expansion, although it was still too early to make a definitive judgment. Factors supporting this assessment included the substantive level of competition, more proposals deemed meritorious than could be funded by agencies, and appraisals by departmental SBIR personnel indicating the high quality of submissions.

Another GAO study, released in April 1998, noted that between 35-50% of SBIR projects had resulted in sales or additional private sector investment. Despite earlier indications of problems associated with multiple award winners, this report found that such firms have similar commercialization rates as single awardees. Critical technology lists were being used to determine agency solicitations and there was little evidence of participation by foreign firms. While several agencies had new programs to assure continuity in funding, there were indications of possible inaccuracies in defining the extramural R&D budgets upon which the set-aside is based.

The June 1999 GAO analysis reported that SBIR awards tend to be concentrated both geographically and by firm despite widespread participation in the program. "The 25 most frequent winners, which represent fewer than 1 percent of the companies in the program, received about 11 percent of the program's awards from fiscal year 1983 through fiscal year 1997." Businesses in a small number of states, particularly California and Massachusetts, were awarded the most number of projects. The study also noted that while commercial potential is considered by all agencies, each has developed different evaluation approaches. Other goals, including innovation and responsiveness to agency mission, still remain important in determining awards.

GAO also has evaluated the STTR program. A January 1996 report found that, in general, federal agencies favorably rated the quality of winning proposals (in the first year) and that most projects had commercial potential, although the costs might be high.

The government had taken steps to avoid potential conflicts of interest between federal laboratories and departmental headquarters. There was no indication that this pilot effort was competing for proposals with the established SBIR activity or "... reducing the quality of the agencies' R&D in general." Instead it was credited for encouraging collaborative work. Yet, GAO noted that because the programs are so similar, there are questions whether or not a separate activity is necessary. Any real evaluation of success in technology transfer, however, could not be accomplished for several years because of the time needed to bring the results of R&D to the commercial marketplace. These findings were reiterated in testimony given by GAO in May and September 1997.

A June 2001 GAO study of all companies which received STTR awards between FY1995 and FY1997 noted the participant's belief that both the firms and the research institutions contributed to expanded R&D although the private sector was more influential in determining the direction of the research. The companies "...reported about \$132 million in total sales and about \$53 million in additional developmental funding." They identified 41 new patents and the creation of 12 new spin-off firms. Further, the awardees preferred that the STTR program remain separate from the SBIR activity.

Awards

From its inception in FY1983 through FY2001, over 64,248 awards have been made totaling more than \$12 billion. The table below summarizes the funding and the number

of projects selected for the SBIR program as provided by the SBA; information on the STTR program is contained in the subsequent chart.

SBIR Program: Dollars Awarded and Projects Funded

Fiscal Year	Dollars Awarded (millions)			Awards		
	Phase I	Phase II	Total*	Phase I	Phase II	Total*
FY1983	44.5	—	44.5	686	—	686
FY1984	48.0	60.4	108.4	999	338	1,337
FY1985	69.1	130.0	199.1	1,397	407	1,804
FY1986	98.5	199.4	297.9	1,945	564	2,509
FY1987	109.6	240.9	350.5	2,189	768	2,957
FY1988	101.9	284.9	389.1*	2,013	711	2,724
FY1989	107.7	321.7	431.9*	2,137	749	2,886
FY1990	118.1	341.8	460.7*	2,346	837	3,183
FY1991	127.9	335.9	483.1*	2,553	788	3,341
FY1992	127.9	371.2	508.4*	2,559	916	3,475
FY1993	154.0	490.7	698.0*	2,898	1,141	4,039
FY1994	220.4	473.6	717.6*	3,102	928	4,030
FY1995	232.1	601.9	834.1*	3,085	1,263	4,348
FY1996	228.9	645.8	916.3*	2,841	1,191	4,032
FY1997	277.6	789.1	1,106.7*	3,371	1,404	4,775
FY1998	262.3	804.4	1,066.7	3,022	1,320	4,342
FY1999	299.5	797.0	1,096.5	3,334	1,256	4,590
FY2000	302.0	888.2**	1,190.2	3,166	1,330	4,496
FY2001	317.1	977.3	1,294.4	3,215	1,533	4,748
FY2002	411.5	1,023.4**	1,434.9	4,243	1,577	5,820

*Includes modifications to previous awards and funds set aside for proposals in negotiation.

**Dollars obligated can include modifications to previous year's awards

STTR Program: Dollars Awarded and Projects Funded

Year	Dollars Awarded (millions)			Awards		
	Phase I	Phase II	Total	Phase I	Phase II	Total
FY1994	18.9	—	18.9	198	—	198
FY1995	23	10.7	33.7	238	22	260
FY1996	22.7	41.8	64.5	238	88	326
FY1997	24.2	44.9	69.1	260	89	349
FY1998	19.7	45.1	64.8	208	109	317
FY1999	24.3	40.6	64.9	251	78	329
FY2000	23.9	45.9	69.8	233	95	328
FY2001	24.2	53.2	77.4	224	113	337
FY2002	36.4	55.4	91.8	356	114	470